(26)

Office - Supreme Court, U. S.
FILED
NOV 5 1943
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

Nos. 427 and 428

INLAND STEEL COMPANY, A CORPORATION,
Petitioner,

vs.

FOREMAN M. LEBOLD AND SAMUEL N. LEBOLD,
Respondents.

BRIEF IN OPPOSITION TO PETITION OF INLAND STEEL COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

SILAS H. STRAWN,
FRANKLIN M. WARDEN,
ARTHUR D. WELTON, JR.,
Counsel for Respondents.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

INDEX.

Table of Cases.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

Nos. 427 and 428.

INLAND STEEL COMPANY, A CORPORATION,
Petitioner,

vs.

FOREMAN M. LEBOLD AND SAMUEL N. LEBOLD,
Respondents.

BRIEF IN OPPOSITION TO PETITION OF INLAND STEEL COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

In its opinion of December 29, 1941, the court below accurately observed:

> "At the outset, giving consideration to the facts involved in the former proceeding and those presented for the first time, it is well to keep in mind that at all of the stockholders' meetings and directors' meetings involved, the majority stockholder, defendant [petitioner], was in control. Defendant, owning 80 per cent of the stock, had the power to determine and did determine the actions of the Steamship Company. It is perfectly apparent, indeed, the officers of defendant

> themselves indicate that their interest was to force dissolution so that they might get rid of the minority interest and take over the assets and business of the Steamship Company. It is only with this elementary indisputable premise in mind that the proper answer to the controversy can be reached." (125 F. (2d) 369, 372.)

The petition now before the court does no more than say that under West Virginia law a majority stockholder may be as free as the wind in the exercise of his powers of corporate control, and that, therefore, the premise asserted and found controlling by the court below may not be considered at all. A short and sufficient answer is found in the following quotation from the very decision of the West Virginia Supreme Court relied on by petitioner (*Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49; 95 S. E. 816, 818), where, with respect to a stockholder's voting rights, the court said:

> "The only restriction upon this right of a shareholder seems to be that the matter must not be illegal nor *ultra vires*, and the action of the *majority* of its shareholders must not be so antagonistic to the corporation as a whole as to indicate that their interests are wholly outside of the interest of the corporation and destructive of the interests of the minority shareholders." (Emphasis supplied.)

In the light of this clear announcement by West Virginia's highest court (relied on by the Circuit Court of Appeals, 125 F. (2d) 369, 374), it is impossible to say that the Circuit Court of Appeals has announced a rule, potentially governing a substantial number of other cases, in conflict with a rule announced by authoritative state court decisions.

Statement.

Petitioner's statement of the matter involved contains much material not germane to the inquiry whether the decision below is actually in conflict with the law of West Virginia or with the decision of this court in *Southern Pacific Ry. Co.* v. *Bogert*, 250 U. S. 483. It also omits many essential facts, most of which are concisely stated in the following two paragraphs from the opinion of the court below of December 29, 1941, reported in 125 F. (2d) 369, 373:

"Defendant says it has not appropriated the business of the Steamship Company. The statutes of West Virginia, Sec. 80, Chap. 31, Art. 1, W. Va. Code of 1931, which control the dissolution proceedings, authorize the majority to dissolve and 'discontinue the business of the corporation.' *Here the business was not discontinued;* defendant took over the boats, it continued to operate them, it continued to devote them to the same transportation that they had always carried on. The business which had been prosperous for twenty-five years was turned over to defendant. By its strategic position, by its dominant situation, it could and did force a sale, bid in the property itself and thereafter continue to operate the business as before. The Steamship Company had been organized many years before to transport freight for hire; it had transported only the freight of defendant; this it continues to do, the only difference being that now the latter realizes all the profit which results from such transportation and the minority stockholders get none of it.

"This transportation business was in no wise the business of the Steel Company. It was the business carried on by the Steamship Company, a business which the defendant expressly said it was going to put out of existence. In its strategic position of dominance, even though it was trustee for the minority

> stockholders, defendant warned plaintiffs that if they did not sell their stock, the Steel Company would end all business relations with the Steamship Company and that they must either sell their stock or see the Steamship Company go out of business. That these threats were not idle, that they were made with the ulterior motive, to bring duress to bear and to force plaintiffs, is now obvious. *The business was never interrupted, never curtailed, never modified but continued without interruption.*" (Emphasis supplied.)

It is thus seen that the alleged conflict with the West Virginia law can arise only if under that law a majority stockholder cannot commit a breach of trust, however completely in his own interest he may exercise his corporate powers. What has already been said affords an adequate basis for determination of the alleged conflict with the West Virginia law.

The alleged conflict with this court's decision in the case of *Southern Pacific Ry. Co.* v. *Bogert*, 250 U. S. 483, can arise only if the standards for determining the value of respondents' stock in Steamship Company could result in enrichment of the minority stockholders at the expense of the majority. The petition, with respect to this matter, gives an erroneous impression of the legal standards of value laid down by the court below, and some comment is necessary.

The court below clearly indicated that the question was "what the existence of the transportation business of that company, which defendant has wrongfully taken, is now fairly worth," and said that the damages were to be measured by "what the stock was really worth as stock in a going, prosperous concern continuing in business." (125 F. (2d) 369, 375.) The court said that consideration must be given to all of the elements of value mentioned in its former opinion, "including value as a going concern." (125 F. (2d) 369, 374.) In the former opinion the court

said that "the determination of value entails necessarily consideration of all elements that enter into value—cost of physical assets, additions, depreciation and appreciation, market price, earnings, the chances of future successful operation, and prospects of continued earnings." (82 F. (2d) 351, 356.)

These references demonstrate that the petition is erroneous when it states that the District Court included, as an asset for valuation, "the asserted property right of the Steamship Company as a going concern to carry the Steel Company's traffic." (Pet., p. 2.) The petition is likewise erroneous in stating that the judgment of the Circuit Court of Appeals represented "a valuation solely of the alleged property right of the Steamship Company to carry the Steel Company's traffic at capacity operation and at going rates for an indefinite time in the future." The courts below simply charged petitioner with the value of the business it appropriated on the date of appropriation.

Jurisdiction.

The petition states (p. 17) that jurisdiction is invoked to review not only the judgments of July 29, 1943 but also the decision on the prior appeal rendered on December 29, 1941, and the ensuing judgment of the court remanding the cause to the trial court for assessment of damages. Whether such jurisdiction exists is not clear. The decision of December 29, 1941 was final in the sense that it fully adjudicated the question of liability and the legal standards to be applied in determining the measure in dollars of that liability. Whether the observations in *Hamilton Shoe Co.* v. *Wolfe Brothers*, 240 U. S. 251, are now applicable is not certain That case was decided when, as the court itself then observed, its power to review by certiorari was "to be exercised sparingly," and when the writ was still referred

to as an "extraordinary writ" (240 U. S. 251, 258). Since the writ of certiorari (in view of the legislative changes of 1925) has become the source of the larger percentage of cases reviewed by the court, it is suggested that the denial of the first petition (April 27, 1942, 316 U. S. 675) may fairly be controlling where the second presents no different question.

As a matter of fact, the result petitioner seeks cannot be reached merely by extending the scope of review to the decision and judgment of December 29, 1941, rendered on the prior appeal in this case. It would be necessary also to review the decision in the first action instituted by respondents, *Lebold* v. *Inland Steamship Company*, 82 F. (2d) 351. As noted, that decision, in order to reverse the District Court's dismissal with prejudice, found that petitioner was a fiduciary, and that the offer to respondents of $700 per share for their stock in the Steamship Company was less than fair because the District Court erroneously concluded "as a matter of law that, in determining the value, it should not take into consideration the earning record of the company." (82 F. (2d) 351, 356; March 18, 1936.) This is a final adjudication of a matter necessary to the decision in that case, binding on petitioner as a stockholder of the defendant in that case (*Royal Arcanum* v. *Green*, 237 U. S. 531; *Converse* v. *Hamilton*, 224 U. S. 243) and not now subject to review by this court (*Toledo Scale Company* v. *Computing Scale Co.*, 261 U. S. 399). It forecloses the arguments now urged by petitioner.

A further question is the absence from the record of the opinion and decree of December 29, 1941. If this were a petition to review a state court judgment the omission would be fatal (*Gersch* v. *Chicago*, 226 U. S. 451). This court has more than once indicated it will not consider matters outside the record before it (*McClelland* v. *Carland*,

217 U. S. 268, 283; *Edward Hines Trustees* v. *Martin*, 268 U. S. 458, 465), although the record of prior litigation may be reviewed when properly pleaded (*Independent Coal Co.* v. *U. S.*, 274 U. S. 640, 647). Paragraph 1 of this court's Rule 38 requires that the record shall include "the proceedings in the court to which the writ is asked to be directed."

SUMMARY OF ARGUMENT.

1. There is no conflict with the West Virginia law. The court below recognized the statutory power of the majority to discontinue the business of the Steamship Company but properly found this to be a power in trust. The majority stockholder of a West Virginia corporation may not use his voting power for the purpose of destroying the interests of minority shareholders in the corporate enterprise (*Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816, 818, *Gilmore Manufacturing Co.* v. *Lewis*, 105 W. Va. 102, 141 S. E. 529, 532). There is nothing to indicate that the West Virginia courts would not have been as quick to condemn petitioner's conduct as was the court below. While West Virginia permits a majority stockholder to purchase corporate assets, the courts will always scrutinize the transaction carefully to determine its complete fairness (*Tierney* v. *United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249, 255), and in a situation where the transaction may not be unscrambled will require payment to a non-assenting minority of their share of the fair value of the corporate assets disposed of (*Tierney* v. *United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249, 255; 89 W. Va. 402, 109 S. E. 339, 341). In this case fair value was based on a method of valuation which gave proper weight to going concern value.

2. There is no conflict with this court's decision in *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483. Indeed, that case is a square authority, relied upon by the court below, for the essential conclusion that petitioner was a fiduciary. The same may be said of this court's decision in *Pepper* v. *Litton*, 308 U. S. 295, 310. There is nothing in the *Southern Pacific case* that conflicts with the controlling principle

adopted by the court below that the minority was entitled to receive the fruits of its capital investment and might not be excluded therefrom. Any contrary decision would be in clear conflict with both of the decisions of this court referred to in this paragraph.

3. Since there is no conflict on the question of West Virginia corporate law, it is immaterial whether the question decided is an important one.

ARGUMENT.

I.

There Is No Conflict Between the Decision of the Circuit Court of Appeals and the Statutes or Decisions of West Virginia.

We are not here concerned with abstract questions of West Virginia corporation law, nor with the statutory power of 60% or more of the stockholders of a West Virginia corporation to "resolve to discontinue the business of the corporation" (Section 80, Article I, Ch. 31, of the Code of West Virginia on Corporations, West Virginia Code of 1937, § 3092). Petitioner did not discontinue, but appropriated and continued, the business of the Steamship Company. As majority stockholder its power to discontinue the business of its subsidiary was a power in trust (*Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, 492, 39 S. Ct. 533, 537, 63 L. Ed. 1099; *Pepper* v. *Litton*, 308 U. S. 295, 306, 60 S. Ct. 238, 245, 84 L. Ed. 281). There is nothing in the West Virginia law that says otherwise.

The cases cited by petitioner do not support the propositions which they are supposed to sustain.

1. *It is not true under the law of West Virginia that a majority stockholder "has no duty to consider the interests of other stockholders."*

In support of this proposition petitioner cites (Pet., p. 20) *Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49, 53, 54; 95 S. E. 816, 817. The court expressly stated in that case that "the action of the *majority* of its shareholders must not be so antagonistic to the corporation as a whole as to indicate that their interests are wholly outside of the

interest of the corporation and destructive of the interests of the minority shareholders'' (95 S. E., at p. 818). The court below relied on this decision (125 F. (2d) at p. 372). To the same effect is *Gilmore Manufacturing Co.* v. *Lewis,* 105 W. Va. 102, 141 S. E. 529, 532.

The comment on the scope of the West Virginia statute in the note from 10 University of Chicago Law Review, 82, (Pet., p. 20) is obviously inconsistent with the clear rule laid down in the above quotation and may be entirely disregarded.

2. *The law of West Virginia does not authorize a majority stockholder to purchase the assets of a corporation for less than their fair value.*

We do not understand the pertinence of the statement (Pet., p. 21) that West Virginia law does not require ''that a majority stockholder purchasing properties of the corporation must account for a price which includes future profits that may be made from those properties.''

There is no such issue in this case. The Circuit Court of Appeals held petitioner liable for going concern value. The court said that elements of value that must be considered included ''earnings, the chances of future successful operation, and prospects of continued earnings'' (82 F. 2, at p. 356). But it required no accounting for future profits.

Reilly v. *Oglesbay,* 25 W. Va. 36, does not consider such a question. After approving the New York rule that directors may not be interested in the purchase of corporate property, the court observed that the corporation in question had no board of directors, and that ''the stockholders assumed and performed the duties which ordinarily belong to a board of directors'' (id., p. 43). Observing that if certain charges of the plaintiffs were true, the majority of the

stockholders "are then in fact both seller and purchaser", the court stated: "This, of course, would not be permitted without the consent and approval of every stockholder of the corporation" (id., p. 44).

These comments by the court shows the inapplicability here of the dictum in the paragraph quoted (Pet., p. 21) that the general rule is that a "stockholder of such corporation may purchase".

The case of *Warren* v. *Black Coal Co.*, 85 W. Va. 684, 690, 102 S. E. 672, 674, considered only the question whether a corporation, organized by the stockholders of an insolvent corporation, may purchase its properties at a fair judicial sale without being charged with its obligations. It has nothing to do with the question here involved.

Tierney v. *United Pocahontas Coal Co.*, 85 W. Va. 545, 559, 102 S. E. 249, 255, while announcing that a sale to a majority stockholder for a fair price would be proper, actually held that the sales there involved were for less than adequate consideration and therefore not binding on the minority stockholders.

Wiley v. *Reaser*, 86 W. Va. 415, 423, 103 S. E. 362, 365, went no further than *Warren* v. *Black Coal Co.*, just discussed, and approved the purchase of corporate property by some of the stockholders at a sale pursuant to execution upon a valid judgment at its fair value.

Howard v. *Tatum*, 81 W. Va. 561; 94 S. E. 965, holds that a director may purchase corporate property when the purchase is pursuant to a stockholder's resolution fixing the price at which the property should be sold. Significant in this case was the court's conclusion that the assets sold brought full value; that all stockholders had an equal opportunity to participate in the purchase; and that a number of persons besides the directors became purchas-

ers, some of them purchasing very much more than any one of the directors (94 S. E., at p. 968).

These cases only support and do not detract from the decision of the Circuit Court of Appeals requiring petitioner to pay to respondents their share of the full value of the business of the Steamship Company which petitioner appropriated.

3. *There is no conflict with the decisions of the West Virginia court in the case of Tierney* v. *United Pocahontas Coal Company.*

The petition correctly states (page 22) that: "Under the law of West Virginia the majority stockholder buying the assets of a corporation must pay a fair price". That was the holding of the Court of Appeals. That was the holding in *Tierney* v. *United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249, 255. There is no conflict.

The petition seeks to create a conflict by asserting that "Under the law of West Virginia, the right to carry the traffic of the Steel Company was not a property right of the Steamship Company to be included in its so-called going concern value" (Pet., p. 23).

The decisions in *Tierney* v. *United Pocahontas Coal Co.* may not be so construed. That was a case where the majority stockholder of two corporations caused their assets to be sold to a third corporation, all the stock of which he owned. The sale price was found to be inadequate and the purchasing corporation was held liable for the difference between what was paid and the fair value of the assets sold. In reaching this conclusion the court did refer (as the petition states, p. 22) to the price at which the assets involved would change hands between a willing disinterested buyer and a willing seller, as a measure of the fairness of the price. In this standard there

is no inconsistency with the decision of the Circuit Court of Appeals.

It is asserted, however (Pet., p. 22), that the Tierney case establishes that a minority stockholder "has no right to an interest in the property after the sale or to an accounting for the profits that the majority may make out of that property. * * * He can only recover for his share of the actual value of the property * * * [and] is not entitled to profits depending upon future conditions and contingencies".

Support for these broad propositions is not to be found in the *Tierney case*. The properties there involved were coal mining leaseholds. The minority urged as an element of value the sum of $2,000,000, representing the *estimated present worth* of profits derivable from operation of the properties, during the potential lives of the leases. The court held that "The probability of profits to arise from the operation of the properties is only a circumstance indicating their value. * * * they cannot be accepted as constituting present values in and of themselves. * * * The trial court limited the evidence of probable profits to its proper function, namely, *reflection of value in the property and rights of the companies*" (109 S. E. 339, 341; emphasis supplied).

The opinion then approved the valuing of the leases, machinery, buildings, appliances, operating capital and equipment of all kinds at a sum equivalent to ten cents per ton for all of the coal subject to the lease. This was an established practice in that business and had no relation whatever to the value of the coal in the ground. Since the court found that a mining lease under which nothing had been done was without market value, the method approved was obviously an enterprise or going concern valuation. The court recognized that a value might also be

based on probable profits but observed that in connection with certain offers "no price was based upon *both* estimated profits and tonnage combined." Since the claimants in that case were allowed recovery on the basis of tonnage value as defined, their duplicitous claim to be allowed something also for prospective profits obviously had to be rejected.

There is no conflict between the decision of the *Tierney case* and the decision of the court below. Respondents have not sought, nor has the court given them a "right to an interest in the property after the sale" (except as possible security (O. R. 15)), nor "an accounting for the profits that the majority may make out of their property." The court below has said that they were entitled to their share of the actual value of the going business of the Steamship Company appropriated by petitioner. There does not seem any doubt that a West Virginia court would have made the same finding.

There is no law in West Virginia which holds that "the right to carry the traffic of the Steel Company was not a property right of the Steamship Company to be included in its so-called going concern value." It is the law of West Virginia, as it is everywhere else, that a majority stockholder must pay fairly for the corporate assets.

II.

There Is No Conflict With the Decision of This Court in Southern Pacific Railway Co. v. Bogert, 250 U. S. 483.

There is no conflict between the decision of the Circuit Court of Appeals and this court's ruling in the *Southern Pacific Co.* v. *Bogert*.

It is true that in the *Southern Pacific case* this court, under the peculiar circumstances of that case resulting

from the floating indebtedness of the old company, properly held that, before the minority stockholders might participate, they would have to make some contribution with respect to such indebtedness. This conclusion naturally followed from this court's declaration that "The purpose of this proceeding is not to punish the Southern Pacific but to declare and enforce its obligation as trustee." (250 U. S. 483, 497.)

Respondents at no time have sought to "punish" petitioner, but only to enforce its obligation as trustee. Indeed, it does not seem possible that under the *Southern Pacific case* any federal court could do otherwise than find that petitioner was a trustee. No other decision could be consistent with the principles announced by this court in *Pepper* v. *Litton*, 308 U. S. 295.

Petitioner in effect asserts, however, that respondents are unjustly enriched by the ruling that petitioner must pay them "a large award of damages arrived at by capitalizing past earnings, resulting from the carriage of the traffic of the Steel Company in the past, a right which was no part of the Steamship Company's 'common property'" (Pet., p. 23). This is merely petitioner's conclusion. If it were sound as a premise, it might provide a basis for invoking the principle of the *Southern Pacific case*. It is not sound as a premise, for the matter of consideration of (not capitalizing) past earnings was only one of the elements of value required under the decision of the court below. Petitioner's real complaint is that it has been adjudicated to be a faithless trustee and has been held to account for the value of that which it wrongfully appropriated for its own use to the detriment of its *cestuis que trustent*. We are not advised of any decision of this court that would not uphold such a conclusion.

The discussion of the stipulation that there was no contractual arrangement between the Steel Company and

the Steamship Company with reference to the carrying by the Steamship Company of the tonnage of the Steel Company is irrelevant. While a trustee's duties may be measured by express contract where it is acting under a written document, there is no need for such a document, and it has long been a primary function of courts of equity to enforce fiduciary obligations. Respondents have not based their claim upon contractual obligation, but upon the higher duty imposed upon a majority stockholder in control of a corporation and its affairs. It may well be doubted whether petitioner would have been deterred by the existence of a mere contract when it so completely disregarded the clear adjudication of the Court of Appeals in *Lebold* v. *Inland Steamship Company*, 82 F. (2d) 351, that petitioner was a fiduciary.

Nor do respondents assert that the traffic arrangement had to be perpetual. Petitioner found it to its interest to maintain this policy during twenty-four years of operation, and sought to "terminate" it only because it wanted to exclude these respondents from their participation in it. Petitioner benefited by the arrangement. This benefit flowed, not only from its own capital invested in the Steamship Company, but also from the capital of respondents. The respondents at no time have resisted petitioner's desire to own the Steamship Company's business outright. They originally offered to arbitrate the question of value, but this petitioner refused to do (O. R. 55). They ask only that they be paid fairly for the value of their investment, which, under policies beneficial to petitioner, greatly increased over the original investment during the life of the Steamship Company. This increase inured to petitioner just as much as to respondents, ratably according to their holdings. Respondents are just as much entitled to their pro rata share as is the petitioner. *But the petitioner is not entitled to the respondents' share.*

III.

Since There Is No Conflict on the Question of West Virginia Corporate Law, It Is Immaterial Whether the Question Decided Is an Important One.

It is clear from what has been said that at most the decision of the Circuit Court of Appeals is an application to the facts of this case of well recognized equitable principles. There is no basis for saying that a West Virginia court would not arrive at the same decision, but whether this be true or not is immaterial.

It is not true that the Court of Appeals has decided that a corporate majority stockholder doing business with its subsidiary "must continue to do so indefinitely or if it terminates the relationship, account on the theory that the business would have continued indefinitely" (Pet., p. 25).

In the case at bar the matter of the continuation of the business is not a *theory*. It is a fact. Petitioner never intended to discontinue the business but only to eliminate respondents from their participation in it. This course of conduct was a breach of its fiduciary obligation, and that is the basis of its liability. As is demonstrated by the opinions of the court below, this conclusion is supported by the overwhelming weight of authority, including West Virginia.

It is respectfully submitted that the petition of Inland Steel Company for a writ of certiorari herein should be denied.

Respectfully submitted,

Silas H. Strawn,
Franklin M. Warden,
Arthur D. Welton, Jr.,
Counsel for Respondents.